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No. 02-857

In the Supreme Court of the United States

HOUSEHOLD CREDIT SERVICES, INC. AND MBNA AMERICA BANK, N.A., PETITIONERS

v.

SHARON R. PFENNIG

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING PETITIONERS

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QUESTION PRESENTED

Whether the Federal Reserve Board reasonably classified a fee imposed by a credit card lender because a consumer has exceeded the credit limit as one of the "other charges which may be imposed" under the account (15 U.S.C. 1637(a)(5)) rather than a "finance charge" (15 U.S.C. 1605(a)), within the meaning of the Truth in Lending Act, 15 U.S.C. 1601 *et seq.*

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INTEREST OF THE UNITED STATES

The Truth in Lending Act (TILA or Act) imposes disclosure requirements on creditors that offer consumer credit plans, such as credit cards. The Board of Governors of the Federal Reserve System (Board) is authorized to issue regulations to carry out the Act. 15 U.S.C. 1604(a). The Board has promulgated a regulation interpreting TILA to provide that fees for exceeding a credit limit should be disclosed as "other charges" (15 U.S.C. 1637(a)(5)) rather than part of the "finance charge" (15 U.S.C. 1605(a)). The Board and the United States have an interest in defending that interpretation. The United States filed an amicus brief at the petition stage in response to this Court's order inviting the Solicitor General to express the views of the United States.

STATEMENT

1. a. The Truth in Lending Act, 15 U.S.C. 1601 *et seq.*, establishes a comprehensive scheme that requires lenders to disclose credit terms to consumers. The disclosures for open-end credit plans, such as the credit card account in this case, vary depending on the stage in the lending process. But the Act and its implementing regulation, Regulation Z (12 C.F.R. Pt. 226), together provide at every stage for disclosure of the fee at issue here—an over-the-credit-limit (OCL) fee, which TILA describes as a "fee imposed in connection with an extension of credit in excess of the amount of credit authorized to be extended with respect to [the] account" (15 U.S.C. 1637(c)(1)(B)(iii)).

TILA also requires disclosures at various times of the "finance charge" (15 U.S.C. 1605(a)) and the "annual percentage rate" (APR) (15 U.S.C. 1606(a)). The "finance charge" is "the sum of all charges, payable directly or indirectly by the person to whom the credit is extended, and imposed directly or indirectly by the creditor as an incident to the extension of credit." 15 U.S.C. 1605(a). Although TILA gives examples of charges that must be included in the finance charge and charges that may or must be excluded, OCL fees are not mentioned in either category. 15 U.S.C. 1605. The APR for an open-end plan is "the quotient (expressed as a percentage) of the total finance charge for the period to which it relates divided by the amount upon which the finance charge for that period is based, multiplied by the number of such periods in a year." 15 U.S.C. 1606(a)(2). Thus, when a finance charge for a given period includes a fee in addition to the account's nominal interest rate, the APR for the period generally increases above the nominal rate to reflect that fee.

TILA requires creditors offering open-end accounts to make disclosures to consumers in solicitations or applications, again before opening the account, and thereafter for each billing cycle under the plan. Direct-mail applications and solicitations must inform consumers of the APRs that may apply under the plan and must specify certain other fees that may be assessed under the plan, including OCL fees. 15 U.S.C. 1637(c)(1) and (3). Additional disclosures before opening the account must identify the conditions under which a finance charge may be imposed, the method used to determine the balance on which a finance charge will be imposed and to determine the amount of the finance charge, and the nominal APR that will be applied to balances. 15 U.S.C. 1637(a)(1)-(4). Creditors must also identify "other charges which may be imposed as part of the plan." 15 U.S.C. 1637(a)(5). For each billing cycle, the creditor must provide a periodic statement that includes, among other things, the outstanding balance, an itemization of the extensions of credit during the billing cycle, the amount of any finance charge added to the account during the billing cycle, and the total finance charge expressed as an APR. 15 U.S.C. 1637(b).

b. TILA gives the Board broad authority to issue regulations to carry out its purposes. The regulations "may contain such classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of transactions, as in the judgment of the Board are necessary or proper to effectuate the purposes of [the Act], to prevent circumvention or evasion thereof, or to facilitate compliance therewith." 15 U.S.C. 1604(a). Creditors that act in good faith reliance on a rule, regulation, or interpretation by the Board or its staff are protected from liability under the civil liability provisions of TILA, even if the rule or interpretation is later rescinded by the Board or held invalid by a court. 15 U.S.C. 1640(f). In order to achieve nationwide uniformity in disclosure requirements, state laws that are inconsistent with TILA or the Board's regulations imple-

menting TILA are expressly preempted. 15 U.S.C. 1610; 12 C.F.R. 226.28(a).

The Board's Regulation Z, adopted pursuant to Section 1604(a), identifies a number of fees that are excluded from the finance charge. 12 C.F.R. 226.4(c). Those fees include "[c]harges for actual unanticipated late payment, for exceeding a credit limit, or for delinquency, default, or a similar occurrence." 12 C.F.R. 226.4(c)(2). The regulation thus expressly excludes OCL fees from the finance charge.

The exclusion of OCL fees dates from a 1981 revision to Regulation Z, which was promulgated following notice and comment. See 45 Fed. Reg. 29,702, 29,735 (1980) (proposed rule); *id.* at 80,648, 80,697 (revised proposal); 46 Fed. Reg. 20,848, 20,855, 20,894 (1981) (final rule). Even before the revision, however, the Board and its staff had issued opinions interpreting the pre-1981 regulatory language to exclude the OCL fees at issue in the opinions from the finance charge. See Official Interpretive Letter FC-0142 (Fed. Reserve Bd. Jan. 9, 1978); Unofficial Staff Interpretation PI-1281 (Fed. Reserve Bd. Feb. 14, 1978).

Consistent with the statutory disclosure requirements, Regulation Z requires creditors to make disclosures with direct-mail applications and solicitations, before the initial use of a credit card plan, and with each billing cycle. 12 C.F.R. 226.5a, 226.6, 226.7. Each of those disclosures must include information about the finance charge and the APRs that may be or were imposed in connection with the credit plan. 12 C.F.R. 226.5a(b), 226.6(a), 226.7(f) and (g). In addition, each of the disclosures must identify OCL fees that may be or have been imposed. Direct-mail applications and solicitations must identify the amount of the OCL fee that the plan might impose. 12 C.F.R. 226.5a(b)(10). OCL fees must also be disclosed before the account is used, and periodic statements must disclose OCL fees if they were imposed during the billing cycle. 12 C.F.R. 226.6(b), 226.7(h)

(requiring disclosure of "other charges" in initial disclosures and periodic statements); 12 C.F.R. Pt. 226 Supp. I, Official Staff Interpretations, Cmts. 6(b)-1(i), 7(h)-4 (listing OCL fees among the "other charges" that must be disclosed).

2. Respondent Sharon Pfennig is a consumer who holds a credit card account originally issued by an affiliate of petitioner Household Credit Services, Inc., and now held by petitioner MBNA America Bank, N.A. On behalf of a purported nationwide class of petitioners' customers, respondent sued petitioners in the United States District Court for the Southern District of Ohio. Pet. App. A31-A41. Respondent alleged that petitioners allowed her to incur charges that caused her balance to exceed her credit limit and then violated TILA when they failed to disclose the resulting OCL fee as a finance charge or to include it in the APR on her periodic statement. *Id.* at A32-A33, A39-A40. Respondent did not allege that petitioners failed to disclose the OCL fee as an "other charge," as required by Regulation Z.

The district court granted petitioners' motion to dismiss the complaint. Pet. App. A24-A29. The court observed that Regulation Z specifically provides that an OCL fee is not a finance charge. *Id.* at A27. The court noted that the regulation excludes from the finance charge several fees, including late fees, delinquency charges, and OCL fees, "all of which arise when the terms under which the credit was extended have been breached by the borrower." *Id.* at A28. The court concluded that the "Board rationally determined that those charges, for acts amounting to breaches of the agreed upon credit extension, are not finance charges." *Ibid.* Accordingly, the court deferred to the Board's regulation, as required under *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555 (1980), and held that petitioner's complaint fails to state a claim upon which relief can be granted. Pet. App. A28.

3. A divided panel of the United States Court of Appeals for the Sixth Circuit reversed. Pet. App. A1-A23. The court

acknowledged its obligation under this Court's decisions to give "deference * * * to the [Board]'s interpretation of [TILA] as long as such interpretations are not irrational." *Id.* at A6. Nonetheless, the court of appeals declined to defer to Regulation Z's provision that OCL fees are not part of the finance charge. *Id.* at A8-A15.

The court of appeals first stated that, "as a remedial statute, [TILA] must be given a liberal interpretation in favor of consumers." Pet. App. A8. The court then went on to conclude that the OCL fee imposed here "falls squarely within the statutory definition of a finance charge." *Id.* at A9. The court noted that TILA defines the finance charge as "the sum of '*all charges*'" paid by the borrower and assessed by the creditor "as an incident to the extension of credit." *Ibid.* The court read respondent's complaint to allege that she was charged OCL fees after she requested and was granted additional credit, because the complaint alleged that petitioners allowed her to incur the charge that caused her account to exceed the credit limit. *Ibid.* The court stated that, "under a plain reading of § 1605(a) and the general rules of statutory interpretation, the [OCL] fee was imposed incident to the extension of credit to [respondent]." *Ibid.*

The court also noted the centrality of disclosure of the finance charge to TILA's remedial purpose, and expressed the view that "'[s]eeing the cold, hard figures [i.e., the finance charge] helps consumers to determine whether to use credit or not,' as high credit costs encourage restraint." Pet. App. A12 (citation omitted). Accordingly, the court concluded that, "considering the language in § 1605(a) defining the finance charge and the language and purpose of TILA as a whole, Regulation Z's exclusion of over-limit fees, such as those imposed in this case, from the 'finance charge' conflicts with the express language of TILA," and "the regulation cannot stand." *Ibid.* The court noted, however, that its holding applies only when "the creditor knowingly permits

the credit card holder to exceed his or her credit limit." *Id.* at A15 n.5.

Finally, the court of appeals considered petitioners' liability to respondent in light of the good faith immunity defense of 15 U.S.C. 1640(f). Pet. App. A15-A18. The court stated that, because the fee in question "was imposed for 'exceeding a credit limit,'" and Regulation Z "unequivocally" permits petitioners to disclose the fee as they did, petitioners were entitled to the good faith defense. *Id.* at A17. The court accordingly affirmed the dismissal of respondent's claim for monetary damages. *Id.* at A18.

Chief District Judge Edgar (sitting by designation) dissented from the court's holding that Regulation Z is invalid. Pet. App. A19-A23. In particular, Judge Edgar disagreed with the court's conclusion that TILA's language unambiguously requires inclusion of OCL fees as part of the finance charge. Observing that OCL fees are not mentioned in TILA's definition of "finance charge," Judge Edgar reasoned that, although the panel majority's interpretation of the statutory language "might well be a reasonable one," the Board's reading is also reasonable. *Id.* at A22. In his view, the Board reasonably analogized OCL fees to other charges, such as those for late payment or delinquency, that "are clearly not a part of the finance charge." *Ibid.* Judge Edgar noted that, in *Milhollin*, this Court held that the Board's regulations construing TILA are "dispositive" unless "demonstrably irrational." *Ibid.* (quoting *Milhollin*, 444 U.S. at 565). Judge Edgar would therefore have deferred to the Board's regulation, which he viewed as a reasonable interpretation of TILA. See *ibid.*

Petitioners sought rehearing and rehearing en banc, and the Board filed an amicus brief in support. Pet. App. A43-A53. The Board's brief took issue with the court's conclusion that an OCL fee is necessarily within the statutory definition of "finance charge." *Id.* at A45-A47. In addition, the Board

challenged the court's assumption that, because petitioners allegedly approved the transaction that caused respondent to exceed her credit limit, petitioners had knowingly permitted respondent to exceed her credit limit and thereby agreed to a renegotiation of the credit limit. *Id.* at A47-A51. The Board explained that creditors almost never have the real-time information necessary to determine whether a particular credit transaction for which approval is being sought will actually cause a consumer to exceed a credit limit. *Id.* at A48-A50. For that reason, when a creditor authorizes a transaction that will ultimately cause the consumer to exceed the credit limit, the creditor is generally not knowingly extending credit in excess of the limit. Creditors therefore do not impose OCL fees until the conclusion of the billing cycle, and the decision to impose the fee is based on a backward look at the account history. *Id.* at A50-A51. The Board also explained that the court's decision would create serious compliance difficulties for creditors and confusion among consumers. *Id.* at A51-A52.

The court denied panel rehearing but amended its opinion to add a footnote that rejected the Board's arguments. See Pet. App. A10 n.2. The court dismissed the Board's explanation of industry practice and the reasons for the regulation as facts that "were never raised below and are not in the record." *Ibid.* The court suggested that concerns about the invalidation of the regulation could be addressed at trial, at which time petitioners could challenge respondent's allegations that they knowingly allowed her to exceed her credit limit by permitting her to incur the charge that had that result. *Id.* at A10-A11 n.2. The full court later denied the petition for rehearing en banc. *Id.* at A30.

SUMMARY OF ARGUMENT

I. This Court has held that the regulations and interpretations of the Board and its staff under TILA should be "dis-

positive" unless "demonstrably irrational." *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555, 565 (1980); see *Anderson Bros. Ford* v. *Valencia*, 452 U.S. 205, 219 (1981) (Board's regulations should be accepted "absent some obvious repugnance to the statute"). The deference rule articulated in *Milhollin* and *Valencia* applies in any case in which a statutory gap or ambiguity in TILA is clarified by a Board regulation or interpretation.

This case involves precisely that situation. TILA does not directly address whether or not fees for exceeding the credit limit on a credit card account (OCL fees) are included in the "finance charge." The "finance charge" is defined to include all charges "incident to the extension of credit," but that phrase is ambiguous. 15 U.S.C. 1605(a). Although the definition of finance charge gives examples of fees that are included and specifies fees that are excluded, the definition does not address OCL fees. Moreover, other provisions of TILA make clear that not every charge associated with a credit agreement is included in the finance charge. And, when TILA expressly addresses OCL fees elsewhere in the Act and requires their disclosure, it does not classify them as finance charges.

In its Regulation Z implementing TILA, the Board has interpreted "finance charge" to exclude OCL fees and other fees that are imposed when a consumer violates the terms of a credit agreement. 12 C.F.R. 226.4(c)(2). Those fees must be disclosed to consumers, but they are disclosed as "other charges," and thus not reflected in the annual percentage rate set forth on a consumer's periodic statement. See 12 C.F.R. Pt. 226 Supp. I, Official Staff Interpretations, Cmts. 6(b)-1(i), 7(h)-4. The Board's classification of OCL fees as "other charges" rather than part of the "finance charge" is a reasonable interpretation of TILA.

OCL fees, like other penalty fees, are rationally viewed as imposed "incident to" the consumer's breach of the agree-

ment rather than "incident to the extension of credit." For the creditor, those fees serve important functions apart from compensating for increased credit risk resulting from a higher balance. For the consumer, those fees are not integral to the cost of credit under the agreement, because the consumer will not incur them by borrowing in accordance with the agreement's terms. Treating all penalty-type fees alike facilitates compliance with TILA by providing creditors with a clear and simple rule and effectuates TILA's purposes by ensuring that consumers are provided with understandable information with which to compare credit costs.

II. The court of appeals erred in invalidating the Board's regulation. The court's reasoning reflects a misunderstanding of the operation of the credit card industry and a mistaken focus on the creditor's knowledge of the consumer's account status. The court of appeals erroneously assumed that the point-of-sale authorization of a transaction that ultimately causes a consumer to exceed her credit limit represents a knowing decision by the creditor to allow the consumer to exceed the limit. On the contrary, the authorization process is designed for a distinct purpose and reflects imperfect information that does not accurately indicate to the creditor whether a particular transaction will push the consumer over the credit limit.

The court also mistakenly assumed that a creditor renegotiates the credit limit when the creditor approves a charge through the point-of-sale authorization process with the awareness that the charge will cause the consumer to exceed the credit limit. If the creditor does not also agree to raise the credit limit for the future, approval of such a transaction does not in itself amount to a renegotiation of the credit limit, and any OCL fee is reasonably viewed as imposed for the breach of the agreement. Nor does the court of appeals' focus on the creditor's knowledge find any other support in

TILA's text. Enforcing a distinction in the disclosure of OCL fees on that basis, moreover, would create a substantial compliance burden for creditors and lead to consumer confusion, thus undermining the purposes of TILA. In any event, even if some small percentage of OCL fees could be classified as "finance charges," the Board acted reasonably in adopting a categorical approach that treats all OCL fees alike.

Finally, the court of appeals was not justified in rejecting the Board's regulation based on TILA's "remedial" purpose and the court's belief that an alternative rule would better protect consumers. Pet. App. A11-A12. The court was incorrect that its rule better protects consumers, and, more fundamentally, it usurped the Board's authority by substituting its own policy judgment for the judgment made by the Board.

ARGUMENT

THE BOARD'S REGULATION Z, WHICH EXCLUDES OCL FEES FROM THE FINANCE CHARGE, REASONABLY RESOLVES AMBIGUITY IN TILA AND SHOULD BE UPHELD

Congress enacted TILA to promote "the informed use of credit" by ensuring "meaningful disclosure of credit terms" to consumers. 15 U.S.C. 1601. Recognizing that the complexity and variety of credit transactions prevents TILA from itself addressing every disclosure issue, Congress delegated expansive authority to the Board to interpret and elaborate upon the Act. 15 U.S.C. 1604. Exercising that authority, the Board has provided in Regulation Z, TILA's implementing regulation, that fees for exceeding the credit limit on a credit card account (OCL fees) are disclosed, not as part of the "finance charge" (15 U.S.C. 1605(a)), but instead as one of the "other charges which may be imposed" under the account (15 U.S.C. 1637(a)(5)). See 12 C.F.R. 226.4(c)(2); 12 C.F.R. Pt. 226 Supp. I, Official Staff Interpretations,

Cmts. 6(b)-1(i), 7(h)-4. The Board's regulation reasonably resolves ambiguity in TILA concerning the treatment of OCL fees and should be upheld by this Court.

I. REGULATION Z REFLECTS A REASONABLE APPROACH TO THE DISCLOSURE OF OCL FEES

A. The Board's Regulations Under TILA Are Entitled To Extraordinary Deference

When a statute is "silent or ambiguous with respect to the specific issue" covered by an authorized and validly promulgated regulation, courts generally must defer to the regulation if it is "based on a permissible construction" of the statute. *Chevron U.S.A. Inc.* v. *Natural Res. Def. Council, Inc.*, 467 U.S. 837, 843 (1984); see *United States* v. *Mead Corp.*, 533 U.S. 218, 229-230 (2001). That principle has heightened force in the context of regulations issued by the Board under TILA.

As this Court has explained, TILA gives the Board unusually "broad administrative lawmaking power." *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555, 566 (1980). See 15 U.S.C. 1604(a) (empowering Board to issue regulations containing such "classifications," "differentiations," "adjustments," and "exceptions" as are "necessary or proper to effectuate the purposes" of TILA). Furthermore, Congress "has specifically designated the Federal Reserve Board and staff as the primary source for interpretation and application of" TILA. *Milhollin*, 444 U.S. at 566. Because creditors need "sure guidance" on how to comply with the "highly technical" Act, Congress has acted to promote reliance on Federal Reserve interpretations by providing creditors with a defense from liability for good faith reliance on rules, regulations, or interpretations by the Board. *Id.* at 566-567; see 15 U.S.C. 1640(f).

That provision is necessary because TILA contains substantial sanctions for violations. Statutory damages, costs,

and attorneys' fees are available for misstatement of the finance charge, and for the overstatement or understatement of the APR by more than 1/8 of one percent in an open-end account. 15 U.S.C. 1606(c), 1640(a); 12 C.F.R. 226.7(f), 226.14(a). If lenders could not rely on Board regulations and interpretations as authoritative statements of TILA's requirements, lenders operating nationwide or regional credit programs would be paralyzed by judicial rulemaking, which might impose different disclosure requirements from jurisdiction to jurisdiction.

The good faith reliance defense "relieve[s] the creditor of the burden of choosing 'between the Board's construction of the Act and the creditor's own assessment of how a court may interpret the Act.'" *Milhollin*, 444 U.S. at 567 (quoting S. Rep. No. 278, 93d Cong., 1st Sess. 13 (1973)). And, as this Court explained in *Milhollin*, that provision also "signals an unmistakable congressional decision to treat administrative rulemaking and interpretation under TILA as authoritative." *Id.* at 567-568.

In addition, because TILA's goal is to enable consumers to compare credit costs so that they can make informed credit decisions, uniform disclosures are critical to the Act's success. Maintaining uniformity in the disclosure regime would be nearly impossible if the disclosure requirements were interpreted through litigation, which is not "the optimal process by means of which to formulate a coherent and predictable body of technical rules." *Milhollin*, 444 U.S. at 568 n.12. Recognizing that fact, the legislative history of TILA "evinces a decided preference for resolving interpretive issues by uniform administrative decision, rather than piecemeal through litigation." *Id.* at 568.

Further, as the Court also explained in *Milhollin*, deference to the Federal Reserve "is compelled by necessity" because the "concept of 'meaningful disclosure' that animates TILA cannot be applied in the abstract." 444 U.S. at 568 (ci-

tation omitted). Meaningful disclosure "does not mean *more* disclosure" but rather entails a policy balance between "competing considerations of complete disclosure" and avoiding "informational overload." *Ibid.* The Board is better suited than the courts to strike the appropriate balance, because doing so requires "investigation into consumer psychology" and "broad experience with credit practices." *Id.* at 568-569.

For those reasons, this Court has adopted an extremely deferential standard for review of Board rules interpreting and implementing TILA. The Court has held that, "[u]nless demonstrably irrational," constructions of TILA by the Board or its staff "should be dispositive." *Milhollin*, 444 U.S. at 565. Thus, "absent some obvious repugnance to the statute, the Board's regulation implementing [TILA] should be accepted by the courts." *Anderson Bros. Ford* v. *Valencia*, 452 U.S. 205, 219 (1981).

That approach makes particular sense in the context of this case. The issue here is not whether OCL fees should be disclosed, but whether they should be disclosed as part of the "finance charge" or as "other charges." On such matters, the precise format for disclosure is less important than providing creditors with clear guidance and ensuring that consumers receive uniform information.

B. TILA Itself Does Not Address Whether OCL Fees Are Included In The Finance Charge

This case involves a straightforward application of the deference rule articulated in *Milhollin* and *Valencia*. TILA does not directly address whether OCL fees should be disclosed as part of the finance charge or instead as other charges that may be incurred under a credit card plan. TILA defines the "finance charge" to include "all charges" imposed on the consumer by the creditor "as an incident to the extension of credit." 15 U.S.C. 1605(a). But TILA makes clear that not every charge associated with a credit

agreement is "incident to the extension of credit." And TILA does not resolve whether OCL fees fall within that descriptive phrase.

The phrase "incident to the extension of credit" is ambiguous. As this Court has recognized, although the preposition "incident to" implies some connection between its object and the antecedent, the term alone does not identify the "nature or extent of the required connection." *Holly Farms Corp.* v. *NLRB*, 517 U.S. 392, 403 n.9 (1996). The "line between practices that are and those that are not performed 'as an incident to or in conjunction with' [other specified activities] is not susceptible to precise definition," and "is not so 'plain' as to bear only one permissible construction." *Id.* at 408 (citing 29 C.F.R. 780.144). Courts should therefore defer to an expert agency's reasonable view of where that line should be drawn. *Id.* at 408-409.

In this case, moreover, surrounding provisions of TILA make clear that Congress did not intend the "incident to" language to incorporate every charge related to an extension of credit. The section defining "finance charge" indicates that certain charges that could reasonably be viewed as "incident to" an extension of credit are not part of the finance charge. See 15 U.S.C. 1605(a) (certain closing costs in real estate transactions); 15 U.S.C. 1605(b) (certain premiums for credit and other types of insurance); 15 U.S.C. 1605(d) (disclosed fees relating to perfecting security interests); 15 U.S.C. 1605(e) (various identified fees incident to the extension of credit secured by real property). Moreover, rather than providing an exhaustive compendium of the items that are included in the finance charge, the definition of finance charge lists "[e]xamples" of charges that are included. 15 U.S.C. 1605(a). Finally, the section prescribing disclosures for open-end credit plans, such as credit card accounts, requires separate disclosure of "other charges which may be imposed as part of the plan" in addition to

disclosure of the method of determining the finance charge. 15 U.S.C. 1637(a)(3) and (5).

Those provisions indicate that the scope of the "finance charge" is not self-evident from the phrase "incident to the extension of credit." Neither the "examples" nor the express exclusions would be necessary if charges "incident to the extension of credit" unambiguously included all those connected to the credit agreement. The requirement that "other charges" be disclosed also would be superfluous if the phrase "incident to the extension of credit" encompassed every charge associated with the extension of credit.

Nor does TILA's text definitively resolve whether OCL fees are included in the finance charge. None of the various examples of charges that are included in the finance charge and none of the specific exclusions address OCL fees. See 15 U.S.C. 1605(a)-(e). Indeed, to the extent that TILA's text expressly addresses OCL fees, it supports the Board's regulatory conclusion that OCL fees are not finance charges. Where TILA addresses OCL fees and requires their disclosure, it does not classify them as finance charges. See 15 U.S.C. 1637(c)(1)(B)(iii) (applications and direct mail solicitations for credit card accounts). Nor does TILA, when it references OCL fees, describe them as imposed "incident to" an extension of credit. See *ibid.* (using the broader phrase "in connection with" rather than the phrase "incident to"). Thus, although Congress was clearly aware of OCL fees, it neither included them in the definition of finance charge nor classified them as finance charges.

C. Regulation Z Reasonably Provides That OCL Fees Are "Other Charges" And Not Part Of The Finance Charge

Because TILA does not itself expressly address the proper classification of OCL fees, the Board, in its implementing regulation, had to decide whether to classify them

as part of the "finance charge" (15 U.S.C. 1605(a)) or instead as one of the "other charges which may be imposed as part of the [credit] plan" (15 U.S.C. 1637(a)(5)). TILA gives the Board broad authority to make "such classifications * * * as in the judgment of the Board are necessary or proper to effectuate [its] purposes." 15 U.S.C. 1604(a). Exercising that authority, the Board reasonably classified OCL fees as other charges rather than finance charges.

That determination is embodied in Regulation Z's exclusion from the finance charge of "[c]harges for actual unanticipated late payment, for exceeding a credit limit, or for delinquency, default, or a similar occurrence." 12 C.F.R. 226.4(c)(2). Those fees must instead be disclosed separately as "other charges." 12 C.F.R. Pt. 226 Supp. I, Official Staff Interpretations, Cmts. 6(b)-1(i), 7(h)- 4.

The Board's determination reflects that those fees are imposed only if the consumer violates the terms of the credit agreement. Because such penalty-type fees are not imposed for the extension of credit in accordance with the agreement but instead for activity in contravention of the agreement, the Board does not consider those fees to be imposed "as an incident to the extension of credit" within the meaning of 15 U.S.C. 1605(a). Accordingly, they are not included in the finance charge.

Excluding from the finance charge fees imposed for the consumer's violation of the terms of the credit agreement is entirely rational. For the creditor, those fees serve important functions apart from compensating for increased credit risk resulting from the higher balance. They deter consumers from violating the agreement and compensate the creditor for the additional risk inherent in dealing with a consumer who does not abide by the agreement's terms. For the consumer, such fees are not integral to the cost of credit under the agreement, because the consumer will not incur them by borrowing in accordance with the agreement. The

Board reasonably concluded that consumers will find the finance charge more meaningful when comparing credit costs if it is calculated based on the assumption that consumers comply with the terms of their credit agreements.

The Board also reasonably concluded that treating penalty-type fees uniformly, rather than distinguishing among them in ways that may not be significant to consumers or creditors, will best facilitate consumer understanding and industry compliance. See 45 Fed. Reg. 80,648 (1980) (noting the value of "precise, easily-applied rules"). A rule that all fees imposed for violation of the terms of the credit agreement are excluded from the finance charge is clear, straightforward, and thus easy for consumers to understand and creditors to follow. In contrast, a rule that drew distinctions among those similar fees might lead to errors in creditors' disclosures or render the disclosures unnecessarily complicated and confusing to consumers.

Based on those considerations, and on its experience under the previous version of Regulation Z in attempting to classify OCL fees on a case-by-case basis, the Board, in 1981, adopted a categorical approach and amended the regulation to list OCL fees among the fees for violating a credit agreement that are expressly excluded from the finance charge. See 46 Fed. Reg. 20,855 (1981) (noting that the revision "adds one item to the list" of penalty fees excluded from the finance charge by "specifically exclud[ing] charges for exceeding a credit limit from the finance charge"). Although the Board and its staff had issued opinions interpreting the pre-1981 regulation to exclude the OCL fees at issue in the opinions from the finance charge, the regulation did not expressly address OCL fees. The 1981 amendment evinces the Board's now long-held judgment that OCL and other penalty

fees are best considered as a group and uniformly excluded from the finance charge.[1]

II. THE COURT OF APPEALS ERRED IN FAILING TO DEFER TO REGULATION Z

Because TILA does not expressly address the proper treatment of OCL fees, and the Board's regulation classifying them as "other charges" rather than part of the "finance charge" is eminently rational, the court of appeals should have deferred to the regulation. Instead, the court held that "the regulation cannot stand" (Pet. App. A12) and adopted its own interpretation of TILA under which OCL fees are sometimes finance charges and sometimes not, depending on whether "the creditor knowingly permits the credit card holder to exceed his or her credit limit" (*id.* at A15 n.5). None of the reasons advanced by the court of appeals for its holding withstands scrutiny.

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[1] The 1981 regulatory amendments were made in response to the Truth in Lending Simplification and Reform Act, Pub. L. No. 96-221, Tit. VI, 94 Stat. 168. In making the amendments, the Board concluded that its prior approach, under which disclosure obligations were based on the actual agreement between the parties even if that differed from the parties' legally enforceable obligations, was not consistent with regulatory simplification. The Board therefore determined that disclosure obligations should "be based only on the legally enforceable obligation between the parties, not on any unenforceable understanding which is at variance with the contract." 45 Fed. Reg. at 80,650; see *id.* at 80,733 (noting that the change was designed to provide clearer standards); *id.* at 80,677 (stating that the prior approach "has proven difficult in application and frequently complicates both the compliance and enforcement burdens"); see also 12 C.F.R. 226.5(c) (codifying the change for open-end credit plans). The categorical exclusion of penalty fees in the current regulation is consistent with that general policy change.

A. The Court Of Appeals' Analysis Ignores The Actual Operation Of The Credit Card Industry

The primary rationale that the court of appeals proffered for rejecting the Board's regulation was that the OCL fees in this case "fall[] squarely within the statutory definition of a finance charge" (Pet. App. A11) because they must be viewed as imposed "incident to the extension of credit" (*id.* at A9). The court concluded that the fees were "incident to the extension of credit" because respondent alleged that they were imposed after petitioners permitted her to incur charges that caused her to exceed the credit limit. *Id.* at A9, A12-A13, A15 n.5. The court equated that allegation with a claim that petitioners knowingly allowed respondent to exceed the limit. *Id.* at A13, A15 n.5. The court then reasoned that respondents thereby "renegotiate[d]" the original agreement to allow respondent more credit, and that a fee imposed as a result of that new agreement is necessarily "incident to this extension of credit." *Id.* at A13. That reasoning is flawed.

The court mistakenly assumed that the point-of-sale authorization of a transaction that pushes a consumer over her credit limit involves a knowing decision by the creditor to allow the consumer to exceed the limit. On the contrary, as the Board explained in its amicus brief below, the point-of-sale authorization process serves different purposes and does not permit a creditor accurately to determine whether authorizing a specific purchase will push a consumer over the credit limit. The authorization process permits a merchant to check whether a card is stolen, the account has been terminated, or transactions on the account have been blocked. The review is handled electronically and virtually instantaneously. Although a part of the review involves a check on the amount of outstanding charges and the credit limit on the account, the authorization process is not

designed to, and does not generally, indicate accurately to either the merchant or the creditor whether a transaction will cause a consumer to exceed the credit limit. Pet. App. A48-A50.

There are a number of practical reasons why the authorization system is not suited accurately to identify over-limit transactions. First, credits to an account are not posted until the end of the day. Thus, at the time authorization is requested, payments or refunds may have been received but not yet posted, so that the charge for which authorization is requested may appear to put the consumer over the limit when in fact it will not do so. Similarly, a transaction that appears to be within a customer's credit limit may simply reflect the fact that other, pre-existing charges have not yet been posted to the authorization system's database. Pet. App. A49.[2]

Second, merchants often seek authorization for amounts that do not reflect actual charges. Some merchants seek authorization for a nominal amount to determine whether a consumer has a "live" card. As a result, the consumer's obligations may be temporarily understated until the merchant posts the actual charge. Other merchants, such as hotels and

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[2] In fact, the situation is even more complex because Regulation Z requires a payment to be posted to an account "as of" the day that it is received, even if it takes a few days for the creditor to process the payment. 12 C.F.R. 226.10(a). Although the "as of" date determines whether the credit limit has been exceeded, the payment does not appear in the authorization database until it is actually processed. For example, a creditor that received a payment on Tuesday would have to post it to the account "as of" that day, even if the payment was not processed and recorded until Thursday. An OCL fee could not be assessed for a charge incurred on Wednesday if the payment brought the balance below the credit limit, even though, at the time that the transaction was authorized on Wednesday, the authorization database would not have reflected the payment, which had not yet been processed.

car rental facilities, block large amounts of credit when a customer checks in or rents a car to ensure that payment will be authorized when the customer checks out or returns the car. That practice means that the consumer's obligations are temporarily overstated. Pet. App. A49-A50.

Those and similar practices result in substantial inaccuracies in the database check performed when a merchant seeks authorization for a credit transaction. A creditor who declined to authorize a transaction because it was potentially over the credit limit based on information available in the authorization database might cause needless hardship and embarrassment to cardholders, and deny credit transactions to which cardholders are entitled by contract. The same limitations that would cause these mistaken credit denials prevent issuers from determining in real time that a transaction is over the limit for purposes of imposing an OCL fee.

For that reason, creditors do not impose OCL fees at the time that they authorize a transaction that may cause the account balance to exceed the credit limit. Instead, they determine whether to impose an OCL fee at the end of the billing cycle, when they can ascertain whether, in light of all charges and credits, the consumer has in fact exceeded the credit limit, and when they can consider other factors, such as the consumer's payment history, the amount by which the limit is exceeded, and how long the account was in over-limit status. Pet. App. A50. For the same reasons, the Board has never placed any significance on what the merchant authorization process might indicate about the possibility that an OCL fee will later be imposed. Instead, the Board rationally characterizes *all* OCL fees as charges for violating the credit agreement rather than finance charges.[3]

[3] The court's statement (Pet. App. A10 n.2) that the Board conceded that there may be instances in which an OCL fee is a finance charge is not correct. The court relied on a footnote in the Board's amicus brief that observes in passing that an OCL fee may not be bona fide in certain limited circumstances. See *id.* at A50-A51 n.8. The Board's brief refers to a situation where a charge is mislabeled as an OCL fee when it is not in fact a penalty imposed for breaching the agreement but is imposed for some other reason. The court seized on that statement as a concession that there were in fact questions for trial. *Id.* at A10. As the Board carefully pointed out in its brief, however, there is no allegation in this case that the fees charged respondent were anything other than bona fide OCL fees. Indeed, the Sixth Circuit itself accepted that the fees imposed here were bona fide OCL fees within the meaning of Regulation Z in holding that petitioners are entitled to immunity from damages. *Id.* at A17 ("it is undisputed that the fee at issue in this case was imposed for 'exceeding a credit limit' ").

B. The Court Of Appeals' Focus On The Creditor's Knowledge Is Mistaken

The court of appeals apparently declined to consider the ordinary operation of the credit card industry because it construed respondent's complaint to allege that petitioners had actual knowledge that the charges that triggered the OCL fees in this case would cause respondent to exceed her credit limit. Pet. App. A10-A11 n.2, A15 n.5.[4] The court suggested that petitioners could avoid liability if they establish at trial that they lacked such knowledge. *Id.* at A11 n.2. But a "knowing" authorization of a transaction that triggers an OCL fee does not in itself amount to a renegotiation of the credit limit. Nor does TILA otherwise make the creditor's

[4] The court also disregarded the Board's explanation of the actual workings of the credit card industry because the information had not been presented to the district court and was not in the record. Pet. App. A10 n.2. But the Board, which is not a party to this case, was not aware of the case when it was in the district court, and the rationality of the Board's regulation cannot be meaningfully assessed without consideration of the information. Moreover, the Board presented the information to counter the court's incorrect assumptions about the operation of the credit card industry, which themselves are without support in the record.

knowledge of the consumer's account status determinative of whether a fee is a finance charge.

1. Even in the unlikely event that petitioners did have actual knowledge that the charges they authorized would cause respondent to exceed her credit limit, it would not follow, as the court of appeals reasoned, that petitioners thereby agreed to a new credit limit going forward and that the subsequent OCL fees were therefore "incident to the extension of credit." Respondent did not allege that petitioners agreed to establish a new credit limit for the future term of a credit agreement. To the contrary, respondent viewed the case as involving OCL fees, which, by definition, involve charges imposed for "exceeding a credit limit." 12 C.F.R. 226.4(c)(2); see Pet. App. A17 (noting that "it is undisputed that the fee at issue in this case was imposed for 'exceeding a credit limit'"). If petitioners had increased respondent's credit limit when authorizing the transactions that triggered the fees, then the fees would not have been "for exceeding a credit limit" because the authorized transactions would not have caused respondent to exceed the new credit limit. Thus, there is no basis to conclude that the authorizations that triggered the OCL fees in this case involved a renegotiation of respondent's credit limit, and consequently there is no basis to conclude that the OCL fees were imposed "incident to the extension of credit."

It is also not necessarily correct, as a general matter, that a creditor's authorization of a transaction knowing that it will cause the customer to exceed the agreed-upon credit limit amounts to a renegotiation of the credit limit for the future. It is just as reasonable to assume that, when a creditor authorizes such a transaction, the creditor is simply allowing a one-time breach of the agreement, subject to existing contractual remedies for that breach. In that case, there would be no renegotiation of the credit agreement, and any fee imposed would still have resulted from the borrower's

violation of the agreement. Accordingly, it would still be reasonable to view the fee as imposed "incident to" the breach of the credit agreement rather than "incident to the extension of credit." Nothing in TILA compels a contrary approach.[5]

2. Nor does anything else in TILA support the court of appeals' conclusion that the Act requires the Board to distinguish among OCL fees based on whether or not the creditor knew that the consumer would breach the credit agreement. The court's rule finds no support in TILA's text. Nothing in the definition of finance charge suggests that whether a fee is a finance charge should turn on the creditor's subjective knowledge of the consumer's current account status. See 15 U.S.C. 1605(a). Nor do any other provisions of TILA require such a rule.[6]

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[5] In some circumstances, it might be reasonable to interpret the phrase "incident to" to permit an act to be "incident to" more than one thing. See *Holly Farms*, 517 U.S. at 403 n.10. Because of TILA's premium on clear and understandable rules, however, it was surely reasonable for the Board to interpret the Act's ambiguous language to preclude such a result under the circumstances here.

[6] The fact that Regulation Z excludes charges for late payment only if the late payment is "actual" and "unanticipated" does not support the court's rule. See 12 C.F.R. 226.4(c)(2). Those limiting adjectives are necessary because the extension of credit always involves a charge for "late payment" in the sense that the creditor permits deferred payment in exchange for a fee. The regulation describes the late payment fees that are excluded from the finance charge as fees for "actual" and "unanticipated" late payment to ensure that the excluded fees are for late payment in contravention of the credit agreement rather than for deferred payment contemplated by the agreement. OCL fees, and other fees for delinquency and default, are by their very nature fees for violating the terms of the agreement; they can never be fees for deferred payment contemplated by the agreement. Therefore, the regulation does not qualify their exclusion from the finance charge with the adjectives "actual" and "unanticipated."

On the contrary, the court's rule would undermine TILA's emphasis on clear and administrable disclosure rules and frustrate TILA's purposes by confusing consumers and unnecessarily burdening creditors. Consumer confusion would result because OCL fees would be disclosed differently on a consumer's periodic statements depending on whether or not the fees were assessed for charges that the creditor knew would cause the consumer to exceed the credit limit. Thus, the periodic statements could vary from month to month for reasons that would be unclear to the consumer. If an OCL fee was imposed based on a charge that the creditor did not know would cause the consumer to exceed the limit, the OCL fee would be listed among the other transactions charged to the account and would have no impact on the APR. If, however, an OCL fee was imposed based on a charge that the creditor knew would cause the consumer to exceed the limit, the OCL fee would be disclosed with a conspicuous label such as "FINANCE CHARGE"[7] and would cause an unexplained increase in the APR for that billing cycle. A consumer would likely be puzzled, and would certainly not be enlightened, by those different disclosures of fees that, from his point of view, result from the same action. Pet. App. A51-A52.

Requiring creditors to distinguish in disclosing OCL fees on the basis of their "knowledge" would also substantially burden card issuers. Issuers would be required to draw lines between OCL fees imposed following a "knowing" authorization and those imposed in the more common "unknowing" circumstances. They would also have to develop complex systems to capture information relevant to whether or not each authorization was "knowing." The cost of misclassification would be significant. Creditors face statutory damages for violations of TILA or Regulation Z equal to twice the finance charge for the transaction (up to the lesser of $500,000 or 1% of the creditor's net worth in the case of class actions), and also must pay the costs of the action and attorneys' fees. 15 U.S.C. 1640(a). Incorrectly placing a "finance charge" in the "other charge" category would subject the lender to liability for misstating the amount of the finance charge. See 12 C.F.R. 226.7(f); 15 U.S.C. 1640(a). If the APR were overstated or understated by more than 1/8 of one percent, that, too, would be a violation. See 12 C.F.R. 226.14(a); 15 U.S.C. 1606(c).

[7] When used with a corresponding amount, the term "finance charge" must be more conspicuous than other required disclosures. 15 U.S.C. 1632(a); 12 C.F.R. 226.5(a)(2).

The statutory and regulatory scheme places a premium on clear rules that give the regulated community the necessary notice to comply. The Sixth Circuit's case-specific, knowledge-based standard is inconsistent with that scheme. With the costs of misclassification so high, and little or no benefit to consumers from a classification scheme as finely calibrated as the Sixth Circuit's, the Board rationally adopted a simple rule that classifies all OCL fees as "other charges," and, at the same time, requires disclosure of those fees in every case.

C. The Board Has Authority To Adopt A Categorical Approach Excluding All OCL Fees From The Finance Charge Even If Some OCL Fees Are Imposed Incident To The Extension Of Credit

Even if the court of appeals were correct that the particular OCL fees in this case were imposed incident to the extension of credit, that would not justify invalidation of the Board's regulation adopting a categorical approach and excluding OCL fees as a class from the finance charge. As already noted, TILA authorizes the Board to make "such classifications, differentiations, or other provisions, and [to] provide for such adjustments and exceptions for any class of

transactions, as in the judgment of the Board are necessary or proper to effectuate the purposes of [TILA], to prevent circumvention or evasion thereof, or to facilitate compliance therewith." 15 U.S.C. 1604(a). Pursuant to that authority, the Board's regulation treats all OCL fees in the same manner and excludes all of them from the finance charge. That classification is rational and not repugnant to TILA, even if one assumes that some OCL fees fall within the definition of a finance charge.

As explained above, in the ordinary operation of the credit card industry, creditors do not know when they authorize a particular transaction whether or not the transaction will cause the consumer to exceed her credit limit. Thus, in most cases, creditors cannot accurately determine whether or not the authorization will ultimately result in the imposition of an OCL fee. It is therefore reasonable to conclude that any OCL fee that is subsequently imposed is not "incident to the extension of credit" but rather incident to the consumer's violation of the credit agreement. Consequently, it is reasonable to classify most OCL fees as "other charges" rather than "finance charges."

Because most OCL fees are reasonably classified as "other charges," the Board could rationally adopt a categorical approach that treats all OCL fees in that manner. As explained above, treating all OCL fees alike facilitates compliance and consumer understanding by providing a clear and uniform rule, consistent with the rule applied to other fees for violations of the credit agreement. See p. 18, *supra*. In addition, the Board's knowledge of the credit card industry suggests that, even if there were a theoretical possibility that certain OCL fees might fall within the definition of "finance charge," it is unlikely that situation would occur with any frequency in practice, and the costs of identifying such occurrences would not be justified. Under those circumstances, the broad deference granted the Board by Congress

clearly encompasses the authority to adopt a bright-line approach excluding OCL fees as a class from the "finance charge." See 15 U.S.C. 1604(a); *Valencia*, 452 U.S. at 222-223 (deferring to Board's interpretation of Regulation Z as excluding certain interest from disclosure as a "security interest" despite apparently contrary statutory and regulatory language); *Mourning* v. *Family Publ'ns Serv. Inc.*, 411 U.S. 356, 374 (1973) (Board's broad regulatory authority under TILA permits it to make classifications that encompass some "conduct the legislation was not intended to deter or control" in order to ensure that "clear violators" do not "escape regulation entirely").

D. The Court Of Appeals Was Not Justified In Rejecting The Board's Rule Based On TILA's "Remedial" Purpose And The Court's Belief That An Alternative Rule Would Better Protect Consumers

The court of appeals' other reason for invalidating the Board's rule also lacks merit. The court classified TILA as "a remedial statute" and purported to give it "a liberal interpretation in favor of consumers in order to protect them in credit transactions." Pet. App. A8-A9; see *id.* at A11-A12. By making its own policy judgment about what would best protect consumers, the court usurped the role that Congress has given to the Board of "striking the appropriate balance" between "complete disclosure" and "informational overload." *Milhollin*, 444 U.S. at 568. In the Board's view, explained above, the interpretation adopted by the court of appeals is not more protective of consumers and indeed will cause consumer confusion. In any event, it is for the Board, not the courts, to determine how such policy considerations should shape disclosure requirements in areas not governed by a clear statutory command. See *id.* at 568-569.

More than 20 years ago, this Court noted Congress's "preference for resolving interpretive issues [under TILA]

by uniform administrative decision, rather than piecemeal through litigation." *Milhollin*, 444 U.S. at 568. The Court explained that administrative rulemaking more readily produces the "coherent and predictable body of technical rules" demanded by this complex Act. *Id.* at 568 n.12. The Court admonished lower courts to "honor that congressional choice" and "refrain from substituting their own interstitial lawmaking for that of the [Board], so long as the latter's lawmaking is not irrational." *Id.* at 568. The Sixth Circuit's decision disregards that admonition and threatens a return to an era when courts routinely issue interpretations of TILA that conflict with those of the Board. Both Congress and this Court have made clear that such judicial rulemaking is antithetical to this statutory scheme.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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